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Letter From Lockyer, Other Treasurers Calls for New Muni Rating Standards

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By Rich Saskal

SAN FRANCISCO - California Treasurer Bill Lockyer, joined by 14 of his peers, **released a letter** yesterday to the three major rating agencies, asking them to create new ratings standards for municipal debt.

The letter in its final form confirms many of the points that were widely publicized in advance of the release, starting with a front-page New York Times article published late Sunday.

It argues that municipal issuers are unfairly penalized by what it calls "differential rating standards" for corporate and municipal debt, which have unnecessarily punished the tax-exempt issuers during the ongoing turmoil in the debt markets.

That turmoil has a lot to do with the troubles of the bond insurance industry, which according to the letter "exists in large part because of your municipal rating scales."

California alone spent $102 million on bond insurance premiums between 2003 and 2007 to obtain triple-A insured ratings, which would not have been necessary if California general obligation bonds were rated by the same criteria as non-municipal debt, the letter says. When California issued taxable GOs last year, Moody's Investors Service assigned a "global scale" rating of Aaa, in addition to its A1 municipal scale rating.

If investors desire distinctions within the municipal credit band, the agencies could offer gradations within the triple-A category, such as AAA-plus or Aaa-minus, the letter suggested.

Market distortions caused by differential ratings are a major reason for the current problems in the variable-rate bond market, the letter said.

To comply with Securities and Exchange Commission Rule 2a-7, money market funds are generally limited to securities that have long-term ratings of double-A and higher.

"To provide that, many municipal issuers purchased bond insurance on their variable-rate demand bonds," the letter said. "Of course, this would not have been necessary if municipal issuers were rated on a corporate scale. Corporations of much weaker credit quality comply with Rule 2a-7 without credit enhancement such as bond insurance."

California deputy treasurer Paul Rosenstiel said yesterday that even if California were rated on the lower end of an expanded triple-A category, the state would still have coveted gilt-edged status, which would be a "very powerful" message for individual investors and for the purposes of Rule 2a-7.

"A lot of the dislocations in our market would have been avoided had we had a market that was built on a true recognition of the risks, and ratings that reflected that," he said.

In a statement yesterday, Fitch Ratings acknowledged receipt of the letter, saying: "It will be considered, as we are continuously open to correspondence from the municipal marketplace."

Standard & Poor's and Moody's did not immediately respond to the letter yesterday.

In addition to Lockyer, the letter was signed by 10 other state treasurers, plus four more officials from major municipal issuers, including Minneapolis chief financial officer Patrick Born, an executive board member of the Government Finance Officers Association and former chairman of the GFOA debt committee.

Andrew Ackerman contributed to this story.
